

Message Text

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ACTION EUR-25

INFO OCT-01 EA-11 ADP-00 CIAE-00 DODE-00 PM-07 H-03 INR-10

L-03 NSAE-00 NSC-10 PA-03 RSC-01 PRS-01 SS-15 USIA-15

AID-20 COME-00 EB-11 FRB-02 TRSE-00 XMB-07 OPIC-12

CIEP-02 LAB-06 SIL-01 OMB-01 STR-08 CEA-02 RSR-01

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R 161345Z AUG 73

FM AMEMBASSY ROME

TO SECSTATE WASHDC 276

INFO AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

USMISSION EC BRUSSELS

AMEMBASSY THE HAGUE

AMEMBASSY LONDON

AMEMBASSY OTTAWA

AMEMBASSY PARIS

USMISSION OECD PARIS

AMEMBASSY STOCKHOLM

AMEMBASSY TOKYO

C O N F I D E N T I A L ROME 8289

E.O. 11652: GDS

TAGS: EFIN PINT IT

SUBJECT: THE RUMOR GOVERNMENT: CURRENT POLITICAL AND ECONOMIC
PROSPECTS

REF: (A) ROME 7376; (B) ROME 7482; (C) ROME 7576; (D) ROME 7793

1. SUMMARY: IN FIVE WEEKS SINCE ITS FORMATION, RUMOR GOVERNMENT
HAS MOVED COHESIVELY AND ENERGETICALLY AGAINST BROAD RANGE OF
IMMEDIATE ECONOMIC ILLS. HOWEVER, SUCCESS OF THESE MEASURES CAN
NOT YET BE GAUGED AND IN ANY EVENT COALITION'S TRUE TEST WILL COME
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WHEN GOVERNMENT MOVES BEYOND EMERGENCY MEASURES INTO DEFINING AND
IMPLEMENTING SOLUTIONS FOR THE LONGER HAUL. UNDERLYING ECONOMIC
FACTORS AND PARTICULARLY BUDGET SITUATION, APPEAR VERY DIFFICULT.
SHOULD GOVERNMENT FAIL IN ITS TASK -- AND TIME IS SHORT --

CONSEQUENCES, POLITICAL AS WELL AS ECONOMIC, COULD BE SEVERE.
END SUMMARY.

2. PRIME MINISTER RUMOR'S RENEWED CENTER-LEFT COALITION HAS PERFORMED IMPRESSIVELY IN ITS FIRST MONTH. FORMED MORE QUICKLY AND EASILY THAN MANY EXPECTED, THE GOVERNMENT HAS THUS FAR COLLABORATED WITH HARMONY NOT SHOWN BY CENTER-LEFT PARTIES IN SEVERAL YEARS. IN PARTICULAR, HIGHLY QUALIFIED ECONOMIC "TROIKA" OF TREASURY MINISTER LA MALFA (REPUBLICAN), FINANCE MINISTER COLOMBO (CHRISTIAN DEMOCRAT), AND BUDGET MINISTER GIOLITTI (SOCIALIST) HAS WORKED TOGETHER WITH ENERGY AND UNITY OF PURPOSE IN SEEKING SOLUTIONS FOR THE COUNTRY'S ECONOMIC PROBLEMS. EMERGENCY ANTI-INFLATION MEASURES (REF A) WERE APPROVED WITH ONLY MINOR TECHNICAL AMENDMENTS BY A UNITED MAJORITY IN PARLIAMENT AFTER BRIEF DEBATE. MEASURES TO REALLOCATE CREDIT TO SMALL AND MEDIUM FIRMS AND SPUR INVESTMENT (REF B) AND TO SUPPORT LIRE (REF C) QUICKLY FOLLOWED. IN RECENT DAYS, INTERIOR MINISTER TAVIANI HAS MARSHALLED LOCAL PREFECTS (WHO CONTROL THE POLICE) TO ENFORCE PRICE FREEZE MEASURES RIGOROUSLY AND HAS CALLED UPON PUBLIC TO ALERT AUTHORITIES TO FOOD PRICE VIOLATIONS. TRIAL AND PUNISHMENT OF VIOLATORS HAS BEEN SWIFT. STRENGTHENING OF LIRE OVER PAST 10 DAYS AND PUBLICITY ACCORDED PRICE FREEZE OFFENDERS IS CONTRIBUTING TO DEVELOPING PUBLIC IMAGE OF VIGOROUS, DETERMINED GOVERNMENT THAT IS ACTING AS WELL AS PREACHING.

3. VIEWED OBJECTIVELY, HOWEVER, OPTIMISM IS SEVERELY STRAINED. THE GOVERNMENT'S GOAL TO PULL COUNTRY OUT OF INFLATIONARY SPIRAL AND CONSOLIDATE ECONOMIC RECOVERY MAY NOT BE ATTAINABLE WITHIN THE TIME FRAME POLITICS WILL ALLOW. AS IMPORTS INCREASE WITH ECONOMIC RECOVERY, UNIT IMPORT COSTS ARE RISING, WHILE THE VALUE OF THE LIRE HAS, DESPITE ITS RECENT MODEST RECOVERY, DEPRECIATED ABOUT 15 0/0 SINCE FEBRUARY. WHOLESAL PRICES HAVE SURGED IN LAST FEW MONTHS WITH THE NEED FOR INCREASED RETAIL PRICES A CERTAIN CONSEQUENCE. THE 1974 BUDGET (CY) IS NOW ONE-THIRD IN DEFICIT, BY \$14.2 BILLION (REF D).

4. IN ADDITION TO INFLATIONARY PRESSURES PRODUCED BY INC-
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REASES IN IMPORT PRICES AND THE DEPRECIATION OF THE LIRA, GOI FACES BUDGETARY SITUATION WHICH WE CONSIDER UNIQUELY DIFFICULT IN THE POSTWARD PERIOD. THE RUMOR GOVERNMENT INHERITED THE 1973 BUDGET, WHICH WAS FRAMED IN 1972 TO GIVE FISCAL STIMULUS AND WILL PRODUCE A CASH DEFICIT OF 7,700 MILLION LIRE (\$13.7 BILLION) OR 30 PERCENT OF BUDGET SPENDING, AT TIME WHEN THE ECONOMIC UPSWING IS STRONGLY UNDERWAY. THE BUDGET FOR 1974 WITH A PROJECTED CASH DEFICIT OF 7.400 BILLION LIRE \$12.7 BILLION) IS ALSO STRONGLY EXPANSIONARY, BUT LITTLE OR NO USABLE EXCESS CAPACITY IS EXPECTED TO BE AVAILABLE.

5. THE ECONOMIC TROIKA, AND PARTICULAR LA MALFA, STRESS THAT
(1) THE BUDGET DEFICIT WOULD HAVE BEEN MUCH WORSE (ABOUT \$24

BILLION) IF GOVERNMENT HAD CONTINUED THE 1970-1972 BUDGETARY TREND, AND BAD (ABOUT \$19 BILLION) IF IT HAD ACCEPTED THE IMPLIED SPENDING LEVELS OF THE 1973 BUDGET. DEFICITS OF THE 1973-1974 MAGNITUDE ARE NOT COMPATIBLE WITH THE ANTI-INFLATIONARY OBJECTIVES OF THE NEW GOVERNMENT. GIOLITTI HAS ALREADY ANNOUNCED THAT THERE WILL BE NEITHER MAJOR TAX INCREASES NOR A BIG STATE LOAN, THUS TYING THE GOVERNMENT TO DEFICIT AT LEAST AS GREAT AS THAT BUDGETED. HOWEVER, UNCERTAINTY OF TAX YIELDS UNDER THE 1973 REFORM OF INDIRECT TAXES AND THE 1974 DIRECT TAX REFORMS FURTHER COMPLICATES DIFFICULTIES. THIS FACTOR, TOGETHER WITH PRESSURES EXPECTED TO DEVELOP FOR ADDITIONAL 1974 SPENDING, GIVES RISE TO WIDESPREAD FEELING THAT, DESPITE LA MALFA'S STRESS ON AUSTERITY, THE GOVERNMENT WILL BE HARD PRESSED TO HOLD DEFICIT TO ITS ALREADY SWOLLEN LEVEL.

6. DESPITE THE DISPATCH WITH WHICH THE NEW RUMOR GOVERNMENT HAS ACTED, MEASURES TAKEN THUS FAR ARE LARGELY STOPGAP. THE PRICE FREEZE ON FOOD-STUFFS IS SCHEDULED TO EXPIRE OCTOBER 31, AND SOME RELIEF WILL DOUBTLESS HAVE TO BE GIVEN TO PRESSURES ALREADY BUILDING UP FOR INCREASES IN OTHER SECTORS. THERE ARE STRONG INDICATIONS THAT THE GOVERNMENT WILL BE FORCED TO AUTHORIZE A GASOLINE PRICE HIKE BY OR BEFORE THAT DATE, A PROSPECT WHICH HAS ALREADY SPARKED CRITICISM FROM UNIONS, THE PSI LEFT MINORITY AND SOME IN THE PSDI AND DC. THE UNIONS SAY THEY WILL GIVE THE GOVERNMENT REASONABLE BREATHING SPELL BUT WARN THAT POSITIVE RESULTS FROM THE ANTI-INFLATION PROGRAM ARE THE PRICE THEY DEMAND FOR LONGER TERM RESTRAINT. IF THE TRADE UNIONS BREAK THE PRESENT FRAGILE TRUCE WITH GOVERNMENT, THE COHESION PRESENTLY CONFIDENTIAL

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BINDING THE COALITION PARTIES AND THEIR COMPONENT FACTIONS INTO A GOVERNING FORCE COULD DISSOLVE.

7. IT IS NOT IMPOSSIBLE THAT RUMOR AND HIS ECONOMIC TROIKA CAN PARLAY THEIR QUICK START INTO VISIBLE PROGRESS BY THIS AUTUMN, THEREBY GAINING TIME IN WHICH TO ACHIEVE EMANINGFUL RESULTS. HOWEVER, THE BIG 1973 AND 1974 BUDGET DEFICITS WILL AT THE SAME TIME SEVERLY HANDICAP A VIABLE ANTI-INFLATIONARY PROGRAM. AS PRESSURE BUILDS UP, EVEN MODERATE SIGNS OF FALTERING COULD SERIOUSLY TEST GOVERNMENT COHESION AND AGAIN BRING INTO QUESTION THE VALIDITY OF CENTER-LEFT COLLABORATION, THEREBY OPENING DOOR TO A VARIETY OF UNDESIRABLE POLITICAL AND ECONOMIC POSSIBILITIES. VOLPE

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